

FINANCE COMMITTEE TESTIMONY TOBACCO TAX ENFORCEMENT

Senator Roger Kahn February 2012

Mr. Chairman, thank you for taking up this important legislation which amends the Tobacco Products Act.

Michigan's tobacco tax rates are among of the highest in the country and certainly the highest in our region, excepting Wisconsin. High tax rates, along with the disparity in tax rates from state to state, drive cross-border and illicit trade of tobacco products. Michigan receives over \$1 billion in tobacco tax revenue, but yearly loses tens of millions of dollars more due to the illicit tobacco trade. Michigan taxes cigarettes at \$2/pack and there are also Master Settlement Agreement revenues to Michigan as well. Nonparticipating manufacturers are taxed through the Michigan Equity Assessment.

The US Government Accountability Office (GAO) released an in-depth study on this issue in March 2011, "ILLCIT TOBACCO – Various Schemes Are Used to Evade Taxes and Fees." The study points out the level of illicit trade is higher in high tax rate states such as Michigan as compared to lower tax states like our neighbor Indiana, and lists the high rewards and low risks in comparison to other crimes as an incentive. As such, states lose significant revenue from lost tax revenues as well as Master Settlement Agreement (MSA) payment revenue.

Michigan has chosen to be a high tax state. As such Michigan has a responsibility and an obligation to collect each and every dollar due. An investment in a comprehensive, statewide tobacco tax enforcement effort will not only return many millions in tax revenues, but also protect Michigan's legitimate wholesalers and retailers who cannot compete against illegal schemes.

Michigan Cigarette Tax Enforcement

Michigan can utilize the new proven technologies in combination with teams of trained enforcement officials to provide enforcement coverage across the state. A coordinated effort between the Michigan State Police, the Attorney General and the Michigan Department of Treasury is capable of significantly reducing illegal activity thereby significantly increasing state tax revenues. We specifically placed money in last year's budget to aid this effort and have been working since then to construct a better program. We have spoken with officials in Indiana, California and Massachusetts as well as our own MSP, Treasury and AG. An effective program will also help us recover escrowed MSA dollars that the cigarette manufacturers have refused to pay Michigan since 2003 claiming we have an insufficient diligence in our contraband program. This was specifically mentioned to us by Carmine Santoro from the Massachusetts department of Revenue.

In 2010, Michigan's cigarette tax collections were just under \$1 billion. This revenue was bolstered to this level when we went to cigarette tax stamps in 1998. That older technology lead

Treasury will be issuing a RFP for a cigarette stamping solution.... May include heat applied stamps applications, digital applications or other with the firm furnishing all materials and services required." Our current supplier, Myercord, is discontinuing the current heat applied stamps and there is no other company that offers those stamps at the old price point. We will experience an increased cost no matter what type stamp we choose.

California has used a "smart" stamp for 7 years and on Dec 28th 2010 they announced: "The high tech stamp and other BOE enforcement efforts combine to reduce cigarette tax evasion by \$133M each year in sales and excise taxes" We followed this up and spoke on 2/6/12 to Cindy Wilson their tax analyst who states that the encrypted stamp and enhanced enforcement together are responsible for their success which includes decreased evasion due to counterfeit cigarette tax stamps. In that meeting were 4 other California officials (Lynn Bartolo, Bill Kimsey, Lou Feletto and Randy Silva) who stated that there has NEVER been compromise of their smart stamp. They also state that having the stamp is an ESSENTIAL part of enhanced enforcement.